Supreme Court, U.S.
FILED
FEB 22 1994
OFFICE OF THE CLERK

No. 93-1198

IN THE
SUPREME COURT OF THE UNITED STATES

OCTOBER TERM, 1993

IN RE: TIME WARNER INC.
SECURITIES LITIGATION

STEVEN J. ROSS, N.J. NICHOLAS,JR., GERALD M. LEVIN, BERT W. WASSERMAN, and TIME WARNER, INC.

Petitioners,

v.

ZVI TRADING CORP. EMPLOYEES' MONEY PURCHASE PLAN AND TRUST and BARRY ZONON

Respondents.

RESPONDENT BARRY ZONON'S RESPONSE TO PETITION FOR A WRIT OF CERTIORI TO THE UNITED STATES COURT OF APPEALS FOR THE SECOND CIRCUIT AND CONDITIONAL CROSS-PETITION

ROGER W. KIRBY, ESQ.
Counsel of Record
KAUFMAN MALCHMAN KIRBY & SQUIRE
Attorneys for Respondent Barry Zonon
919 THIRD AVENUE, 11TH FLOOR
NEW YORK, NEW YORK 10022
(212) 371-6600

COUNTER STATEMENT OF QUESTIONS PRESENTED

1. Whether a complaint should be dismissed although plaintiff may prove facts in support of his claim that would entitle him to relief?

2. Whether *Basic v. Levinson*, 485 U.S. 224 (1988), requires courts to make determination at the pleading stage of the precise monetary impact of information on stock market prices?

3. Whether in a rule 10b-5 securities fraud case, (a) it can be determined as a matter of law that investors consider immaterial statements of reporters and analysts attributed to unnamed persons within publicly traded companies, and (b) whether federal rule of civil procedure 9(b) requires the identification of corporate spokesmen?

4. Whether in a rule 10b-5 securities fraud case, it can be determined at the pleading stage that statements were immaterial, although they appeared to provoke a material market response?

TABLE OF CONTENTS

		Page
TABLE OF CONTENTS		i
TABLE OF AUTHORITIES		iii
COUNTER STATEMENT		1
A.	Factual Background	1
B.	The Decision of the Court of Appeals	4
REASONS FOR DENYING THE PETITION		9
REASONS FOR GRANTING THE CROSS-PETITION		10
ARGUMENT		10
I.	THE DECISION BELOW MERELY INVOLVES NARROW GROUNDS INVOLVING QUESTIONS OF FACT	10
A.	The Decision's Holding On *Scienter* Concerned An Issue of Fact	11
B.	The Issue Of *Scienter* Could Not Have Been Determined As A Matter Of Law	12

C. Petitioners' Alleged Expectations Regarding Inflation Were Neither Illogical Nor Irrational. 13

D. Petitioners' Arguments Are Entirely Irrelevant To The Alternative *Scienter* Theory. 17

II. IF THE COURT GRANTS THE PETITION, THEN IT SHOULD REVIEW THE SECOND CIRCUIT'S DETERMINATION THAT CERTAIN STATEMENTS ARE NOT ACTIONABLE . . . 18

A. Statements By Unnamed Corporate Spokesmen Are Not Necessarily Immaterial. 19

B. The Second Circuit Wrongly Concluded That The Contents Of Pre-May 1, 1991 Statements Were Not Actionable As A Matter of Law. . . 21

CONCLUSION 24

TABLE OF AUTHORITIES

CASES

Page(s)

Abell v. Potomoc Ins. Co.,
858 F.2d 1104 (5th Cir.1988),
vacated in part on other ground
sub nom. 16

Abell v. Wright, Lindsey & Tennings,
492 U.S. 918 (1989) 16

In re Apple Computer Securities Lit.,
886 F.2d 1109 (9th Cir. 1989) . . . 14-15, 16, 19

Backman v. Polaroid,
893 F.2d 1405 (1st Cir. 1990)
(opinion withdrawn) 5

Basic v. Levinson,
485 U.S. 224 (1988) . . . . . *passim*

Beck v. Manufacturers Hanover Trust Co.,
820 F.2d 46 (2d Cir. 1987),
cert. denied, 44 U.S. 1005 (1988) 12

Conley v. Gibson,
355 U.S. 41 (1957) 7, 9, 10

Craftmatic Securities Litigation v. Kraftsow,
890 F.2d 628 (3rd Cir. 1989) 20

DiVittorio v. Equidyne Extractive Inds., Inc.,
822 F.2d 1242 (2d Cir. 1987) 11

Elkind v. Liggett & Myers,
635 F.2d 156 (2d Cir. 1980) 11

Fryar v. Abell,
492 U.S. 914 (1989) 16

Garcia v. Cordova,
930 F.2d 826 (10th Cir. 1991) 20

Hanon v. Dataproducts Corp.,
976 F.2d 497 (9th Cir. 1991) 9, 15, 23

Herman & MacLean v. Huddleston,
459 U.S. 375 (1983) 5

Huddleston v. Herman & Maclean,
640 F.2d 534 (5th Cir. 1981),
modified, 459 U.S. 375 (1983) 9, 11

Levinson v. Basic,
871 F.2d 562 (6th Cir. 1989)
(on remand from Supreme Court) 9, 20

Mayer v. Mylod,
988 F.2d 635 (6th Cir. 1993) 23

Michaels Bldg. Co. v. Ameritrust Co., N.A.,
848 F.2d 674 (6th Cir. 1988) 20

Panzirer v. Wolf,
663 F.2d 365 (2d Cir. 1981) 19

Ross v. Bank South, N.A.,
837 F.2d 980 (11th Cir. 1988) 9, 15

Ross v. Bank South, N.A.,
885 F.2d 723 (11th Cir. 1989) 13

Rowe v. Maremont Corp.,
850 F.2d 1226 (7th Cir. 1968) 9, 20

Schoenbaum v. Firstbook,
405 F.2d 215 (2d Cir. 1968) 11

Shapiro v. UJB Financial Corp.,
964 F.2d 272 (3rd Cir. 1992) 23

Sirota v. Solitron Devices, Inc.,
673 F.2d 566 (2d Cir. 1982) 9, 15

State Teachers Retirement Board v. Fluour Corp.,
654 F.2d 843 (2d Cir. 1981) 11

TSC Industries, Inc. v. Northways,
426 U.S. 438 (1976) 20, 22

United States v. Indelicato,
856 F.2d 1370 (2d Cir. 1989) 12

Virginia Bankshares, Inc. v. Sandberg,
111 S.Ct. 2749 (1991) . . . . . 10, 19, 21 - 23

Wielgos v. Commonwealth Edison Co.,
892 F.2d 509 (7th Cir. 1989) 19

STATUTES

Securities Exchange Act of 1934 . . . . . 4, 22

Securities Exchange Act Rule 10b-5 . . . . . passim

Securities Exchange Act Rule 14a-9 22

Fed. R. Civ. P. 8 20

Fed. R. Civ. P. 9(b) 20

TREATISES

Ian Ayres, *Back to Basics: Regulating How Corporations Speak to the Market*, 77 Va. L. Rev. 945, 970-71, 974-77, 983-85, 996 (1991) 13

Roger J. Dennis, *Materiality and the Efficient Capital Market Model: A Recipe for the Total Mix*, William & Mary L. Rev., Vol. 25 No. 3, 373, 381 (1984) 14

Donald C. Langevoort, *Theories Assumptions, and Securities Regulation: Market Efficiency Revisited*, 140 U. Pa. L. Rev. 851, (1992), cited by 13

David J. Schulte, *The Fraud on the Market Theory: Efficient Markets and the Defenses to an Implied 10b-5 Action*, 70 Iowa L. Rev. 975, Sec. I.C. p. 985 (1985) 14

Andrew R. Simmonds, Kenneth A. Sagat and Joshue Ronen, *Dealing with Anomalies, Confusion and Contractions in Fraud on the Market Securities Class Actions*, 81 Ky. L.J. 123, 146-47, 154-59, 161, Sec. V. 163-86 (1993) 13

Wright & Miller, *Federal Practice and Procedure*: Civil 2d §1298 (1990) 20

RESPONDENT'S BRIEF IN OPPOSITION AND IN SUPPORT OF CONDITIONAL CROSS-PETITION

Respondent Barry Zonon submits this brief in opposition to the petition. The petition should not be granted because the second circuit's decision implicated only well-settled questions of law. In the event the petition is granted, then respondent respectfully requests that the cross petition also be granted.

COUNTER STATEMENT

A. Factual Background

Following the January 1990 merger of Time, Inc. and Warner Communications, Inc. to form Time Warner, Inc. ("Time Warner"), Time Warner management considered a variety of ways to reduce the approximately $8 billion in debt brought about by the merger.

In November 1990, Merrill Lynch Capital Markets made a presentation to Time Warner executives concerning restructuring (34a & n.7)[1]. A rights offering was a featured component of that presentation. Rights offerings generally provide shareholders with the right to acquire shares at less than current stock market prices. Such offerings are dilutive and make capital demands on shareholders. For these reasons they are frequently viewed negatively in the marketplace. At about the same time, Time Warner considered the pursuit of so-called strategic partners, prospective business combinations meant to infuse billions of dollars of capital into the company.

---

[1]. Parenthetical references are to the petition, unless otherwise indicated.

Such capital would be used to reduce Time Warner's debt and alleviate the impending problems associated with debt repayment obligations. Strategic alliances would relieve existing shareholders of a call to contribute capital, and would not dilute the shares outstanding.[2] Statements touting Time Warner's prospects for strategic alliances were regarded as optimistic (17a, 26a) and therefore bullish for Time Warner.

By late 1990, petitioners voluntarily and publicly disclosed their search for strategic alliances. Petitioners' disclosure duties were entirely self-inflicted. They could have instructed their advisors to search out prospects in a discrete and confidential manner. Had petitioners taken that tack, they arguably would not have assumed any duty to keep the marketplace abreast of important changes in the plan for strategic partnerships.[3] But that is not what petitioners did.

As the second circuit observed, throughout the class period petitioners *voluntarily* "publicly hyped" their search for allies (29a) through all of the formal and informal means available to a publicly traded company.[4] But between the

---

[2]. An explanation of these two types of financial actions appears at 27a.

[3]. See, *Basic*, 485 U.S. at 239 n.17.

[4]. Petitioners referred to the strategic partnership scheme in the company's 1990 SEC 10-K statement, its 1990 annual report, in press releases, and in interviews quoting one or more high level Time Warner executives (24a - 25a, n.3). In addition, a skein of articles and analysts' reports that did not

(continued...)

commencement of the alleged class period, December 12, 1990, and its close on June 6, 1991, the company did not disclose that, in addition to considering pursuing strategic alliances, Time Warner was actively considering a rights offering. Nor did Time Warner disclose that it had become unlikely that a strategic ally would be found before other financial efforts had been undertaken.[5] No later than May 13, 1991, Time Warner's board of directors finance committee had begun to consider the rights offering alternative as "a serious viable alternative to the company's capital structure issues."[6] The company's increasing consideration of the rights offering

---

[4](...continued)
identify specific company spokesmen appeared (21a - 22a, n.2). These unattributed articles conformed in essence with the company's own pronouncements.

[5]. In this regard, petitioners seem less than genuine in advising that in October 1991 the company announced an alliance (3). This liaison took place after the proceeds of the rights offering eliminated more than $2 billion of debt (*ibid.*)

[6]. A.594. Subsequent to filing the complaint that was the subject of the dismissal motion, respondents obtained some documents from a Delaware proceeding. Although not in the pleading, some of the information in these materials was supplied to the district court and included in the record on appeal. When referred to herein, such information will be cited by their record references ("A.___").

accompanied the company's persistent failure to allure a strategic ally.[7]

Although we cannot and do not at this time propose to value precisely each bit of market information, suffice that there can be little dispute that petitioners' statements concerning strategic alliances stimulated the marketplace. During the class period, the price of Time Warner's common shares surged from a pre-split $86.00 each on December 12, 1991 to $119.00 on June 3, 1991, two days before defendants belated disclosure of the rights offering. Following public announcement of the offering, Time Warner shares declined $11.25 each from $110.75 per share on June 5, 1991 to $99.50 on June 6, 1991 and then drifted down a few dollars more.

B. The Decision of the Court of Appeals

The second circuit reversed the district court's dismissal of counts I and II of the complaint but affirmed the order of dismissal of count III.[8] The court of appeals remanded the matter for further proceedings consistent with its opinion.

---

[7]. A.281, n.4. The company's registration statement for the rights offering subsequently acknowledged the failure of the strategic alliance plan, when it reported that the rights offering was necessary to "enhance the company's ability to effect [alliances] in a more expeditious and favorable manner." (Form S-3, June 6, 1991, p. 8.)

[8]. Count I alleged violations of sections 10(b) and 20(a) of the Securities Exchange Act of 1934 ("Exchange Act") and rule 10b-5 promulgated thereunder. Counts II and III pleaded common law fraud and negligent misrepresentation.

To the extent that it reversed, the court of appeals was guided by the most conventional of principles, namely; the court was not satisfied beyond doubt that respondents could not prove facts in support of their claim that would entitle them to relief. The second circuit's decision turned on narrow grounds involving questions of fact. As the court stated on the issue of nondisclosure:

> "Whether consideration of the alternate approach [rights offering] constitutes material information, and whether nondisclosure of the alternate approach renders the original disclosure [strategic alliances] misleading, remain questions for the trier of fact, and may be resolved by summary judgment when there is no disputed issue of material fact. *We conclude here only that the allegations in the complaint of nondisclosure of the rights offering were sufficient to survive a motion to dismiss.*"

(29a) (emphasis supplied).

The principle that governed reversal of the issue of *scienter* was of the same unremarkable stripe. The appellate court divided *scienter* into the usual two groups, motive and opportunity, and recklessness,[9] and then addressed each in turn.

---

[9]. Although this court has expressly and repeatedly declined to address whether reckless behavior could satisfy the *scienter* requirement, *Herman & MacLean v. Huddleston*, 459 U.S. 375, 378 n.4 (1983), no fewer than eight circuits have held that it does. See, *Backman v. Polaroid*, 893 F.2d 1405 (1st Cir. 1990) (opinion withdrawn) (collecting cases).

Respecting motive and opportunity, the court correctly understood the alternative *scienter* theories that respondents were posing:

> "defendants were motivated to misrepresent the status of the strategic alliance negotiations to avoid jeopardizing talks with prospective partners, and to withhold disclosure consideration of the rights offering to maintain a high stock price prior to announcement of the new rights offering in order to lessen the dilutive effect" (30a).

Then rightly held that,

> "it is not clear, at least at this threshold stage of the lawsuit, that the defendants had nothing to gain by playing up strategic alliances by simultaneously keeping secret until the last moment the alleged act of consideration of the rights offering" (31a).

The court similarly relegated to the trier of facts to determine the extent to which the dissemination of false information had artificially inflated the market and the extent to which the subsequent disclosures had drained off that inflation (31a, 34a). It also partitioned the *scienter* element from the reliance one, determining that it was not irrational for petitioners to have expected that some inflation would remain in the market place following disclosure (32a - 33a). After all, the calculus of market efficiency has not risen to the level of a Newtonian law, and the precise impact of any particular

disclosure or omission is widely debated in the world of economics (33a - 34a).[10]

The second circuit's segregation of *scienter* from reliance was also routine procedure. Decisions are too numerous and the point too obvious to require extended discussion that these are separate elements, generally subjected to separate analyses. See, p. 14 below.

Also of the plain vanilla variety was the appellate decision to leave to a later day the issue of whether the pleadings adequately alleged conscious or reckless behavior, noting that respondents "have proposed to amend their complaint to supplement this necessary allegation, and [that] this amendment may well be adequate. We will leave it to the District Court to determine whether to allow plaintiffs the opportunity to amend their complaints so as to support an additional theory of *scienter*, and, if this opportunity is provided, to determine in the first instance whether such a theory is adequate" (34a - 35a).

In short, in reversing the district court the majority did no more than abide by this Court's admonition that a complaint should not be dismissed unless "it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief". See *Conley v. Gibson*, 355 U.S. 41, 45-46 (1957) (19a).

Turning to the dissent. Judge Winter would have disposed of the complaint on the grounds that it was "implausible * * * that [petitioners] failed to make early

---

[10]. See, n. 16 *infra*.

disclosure because of the fear that potential partners would be scared off by the bad news [of the variable rights offering]" (38a). That was not, however, the alternate *scienter* theory. As the majority had observed, it was that potential partners would not be encouraged to step forward if it were disclosed that other prospects has rejected Time Warner's overtures or even that a rights offering was being considered (30a).[11] The dissent also ignored the possibility that petitioners had been recklessly indifferent to their undisputed duties to update the market.

Second, the dissent conflated the efficient market theory, which is no more than an evidentiary convenience concerning reliance (*Basic*, 485 U.S. at 245 *et seq.*), with the element of *scienter*. The dissent aggravated this error by its personal view of the dollar value of a given piece of market information. Without benefit of a factual record, fact findings or expertise, the dissent was prepared to determine that it was predictable as a matter of law that the disclosure of the rights offering necessarily and predictably would completely exhaust *all* inflation from the stock market price (40a - 41a).[12]

---

[11]. Rights offerings are generally below market prices. Advising strategic prospects that the company might sell equity at below market would be incompatible with efforts to obtain top dollar from such prospects. The company's motive was to do what it could to attract investors' capital. And it had the opportunity to disclose and to shape corporate news in the manner it considered most congenial to its objective.

[12]. At 42a, the dissent obliquely acknowledged that some factual inquiry may be required to determine how much

(continued...)

REASONS FOR DENYING THE PETITION

The decision below does not merit plenary review. It does no more than apply the time honored *Conley v. Gibson* principle for determining whether or not a pleading should be dismissed to the traditionally fact-determined issues of whether statements were materially misleading, their precise impact on the marketplace, and the presence of *scienter*. Decision after decision have uniformly held that each of these issues is to be left to the trier of fact upon a full record.[13] The petition simply does not involve either a conflict in the law or an important federal legal question.

---

[12](...continued)
inflation may be cured by disclosure. "Why doesn't the dashing of hopes . . . lead to overcorrection instead of undercorrection?" Well, it may. And that is why, although there is little controversy about existence of an efficient market theory, much has been and continues to be written about the valuative impact of particular information on a particular stock at a particular moment. See note 16, *infra*.

[13]. Whether a statement is materially misleading is a mixed question of fact and law: *Levinson v. Basic*, 871 F.2d 562, 564 n.1 (6th Cir. 1989) (on remand from Supreme Court); *Rowe v. Maremont Corp.*, 850 F.2d 1226, 1234 (7th Cir. 1988). Impact on Market: *Hanon v. Dataproducts Corp.*, 976 F.2d 497, 503-04 (9th Cir. 1992); *Ross v. Bank South, N.A.*, 837 F.2d 980, 1001-02 (11th Cir. 1988); *Sirota v. Solitron Devices, Inc.* 673 F.2d 566, 574 (2d Cir. 1982). See note 17, *infra*. Presence of *Scienter*: *See, e.g., Huddleston v. Herman & MacLean*, 640 F.2d 534, 546-47 (5th Cir. 1981), *modified*, 459 U.S. 375 (1983) and cases cited *infra*.

REASONS FOR GRANTING THE CROSS-PETITION

In the event the petition is granted we respectfully submit that two issues would merit plenary review.

First, in determining that statements attributed to unnamed corporate spokesmen by reporters and analysts are not actionable as a matter of law, the court of appeals improperly ruled that rule 9(b), Fed. R. Civ. P., requires additional specificity, and also that investors give no weight to information in articles and reports where the author has not cited a specific, attributable source from within the company (23a). This holding is in conflict in other circuits, and the import of *Basic*. See pp. 20-23 *infra*.

Second, the court of appeals concluded that disclosures prior to May 1, 1991 concerning strategic alliances were too vague to impose disclosure duties (26a), and therefore the court prematurely truncated the class period (35a n.8). This holding conflicts with this Court's decision in *Virginia Bankshares, Inc. v. Sandberg*, ___ U.S. ___, 111 S.Ct. 2749, 2758-60 (1991).

ARGUMENT

I. THE DECISION BELOW MERELY INVOLVES NARROW GROUNDS INVOLVING QUESTIONS OF FACT.

The issues that petitioners posit as being at stake are noncontroversial. Each arises from the fundamental principle that a complaint should not be dismissed unless "it appears beyond doubt that the plaintiff can prove no set of facts in support of his claim which would entitle him to relief." *Conley v. Gibson*, 355 U.S. at 45-46. In cases such as this, where

plaintiffs have not had access to discovery, and virtually all discoverable information resides with the adversary, the dismissal threshold is even higher. *DiVittorio v. Equidyne Extractive Inds., Inc.*, 822 F.2d 1242, 1248 (2d Cir. 1987) (citing treatise); *Schoenbaum v. Firstbrook*, 405 F.2d 215, 218 (2d Cir. 1968).

A. The Decision's Holding On *Scienter* Concerned An Issue of Fact.

Petitioners do not take issue with the propriety of court of appeals conclusion that whether the rights offering constituted material information that rendered the original disclosure misleading is fact-centric and generally unresolvable on motions to dismiss.[14] The court of appeals was equally correct in its analysis of intent. Appellate courts have repeatedly held that the existence of *scienter* is question of fact. *State Teachers Retirement Board v. Fluor Corp.*, 654 F.2d 843, 855 (2d Cir. 1981); *Huddleston v. Herman & MacLean*, 640 F.2d 534, 546-47 (5th Cir. 1981), *modified*, 459 U.S. 375 (1983); *Elkind v. Liggett & Meyers Inc.*, 635 F.2d 156, 167 (2d Cir. 1980).

---

[14]. And how could they in light of the kindred nature of the facts underlying this case those of *Basic*? In *Basic*, this Court rejected a bright-line disclosure standard for materiality concerning a corporate takeover in favor of the fact-centric standard of what the reasonable investor would consider to have significantly altered the total mix of available information. 485 U.S. at 231-32, 240.

Citing second circuit authority, authority without conflict in other circuits,[15] the court held, again, that *scienter* requirements may be satisfied in one of two ways. Either facts have to be alleged that establish a motive to commit fraud and an opportunity to do so, or the facts alleged must constitute circumstantial evidence of either reckless or conscious behavior (29a - 30), citing *Beck v. Manufacturers Hanover Trust Co.*, 820 F.2d 46, 50 (2d Cir. 1987), *cert. denied*, 484 U.S. 1005, (1988), *overruled on other grounds by United States v. Indelicato*, 865 F.2d 1370 (2d Cir. 1989) (*en banc*).

And as noted, the second circuit identified alternative motives that may have prompted petitioners to withhold corrective disclosures.

B. The Issue Of *Scienter* Could Not Have Been Determined As A Matter Of Law.

Petitioners focus on the dissent's erroneous conclusion that one of the *scienter* theories "defies common sense" (9). This was the theory that Time Warner withheld disclosure of consideration of the rights offering to maintain a high stock price prior to announcement of the new rights offering in order to lessen the dilutive effect (30a). The dissent and petitioner contend that the efficient market theory, as contained in *Basic*, 485 U.S. at 241 *et seq.*, compels the matter-of-law conclusion that full disclosure of the rights offering would have deflated the market completely, returning it to its pre-inflated price levels and eliminating any benefits that the company might achieve by an inflated stock price (9).

---

[15]. See, pp. 6-7 *supra*.

There is no justification either for grafting the evidentiary presumption (*i.e.*, the efficient market theory) respecting reliance onto the element of *scienter*, or for the conclusion that all market information is equally valuable. See, 485 U.S. at 245 *et seq.* (fraud on market theory just an evidentiary presumption concerning 10b-5 element of reliance). *Cf., Ross v. Bank South, N.A.*, 885 F.2d 723, 729-30, 749 (11th Cir. 1989) (illustration of typical analysis of 10b-5 claim in which the elements of reliance and *scienter* are treated discretely). Both petitioners and dissent fail to recognize the distinctions between these 10b-5 elements.

C. Petitioners' Alleged Expectations Regarding Inflation Were Neither Illogical Nor Irrational

There is wide agreement that market prices reflect available information. But the measurable dollar/share price value of any particular piece of news remains and is likely to remain warmly contested among market "scientists." See, *e.g.*, Donald C. Langevoort, *Theories Assumptions, and Securities Regulation: Market Efficiency Revisited*, 140 U. Pa. L. Rev. 851 (1992), cited by the majority at 32a - 33a.[16] Therefore,

---

[16]. Consider the treatises cited in *Basic*, 485 U.S. at 246-47 & n.24 & n.26. *See also*, Andrew R. Simmonds, Kenneth A. Sagat and Joshua Ronen, *Dealing with Anomalies, Confusion and Contradiction in Fraud on the Market Securities Class Actions*, 81 Ky. L.J. 123, 143-47, 154-59, 161, Sec. V. 163-86 (1993) (quantitative models to calculate continued mispricing after corrective disclosure); Ian Ayres, *Back to Basics: Regulating How Corporations Speak to the Market*, 77

(continued...)

it cannot be held as a matter of law to have been illogical or irrational for petitioners to have expected to retain some inflation in Time Warner stock following disclosure of the rights offering.

In *Basic*, this Court recognized the distinction between as a matter of law acceptance of the concept of an efficient market and the need for case by case valuation of information flowing into the marketplace. 485 U.S. at 249 & n.29. Consistently, trials revolving around such issues have required the offer of expert testimony aimed at determining both the materiality and value of market news. *See, e.g., In re Apple*

---

[16](...continued)
Va. L. Rev. 945, 970-71, 974-77, 983-85, 996 (1991) (markets are *informationally* efficient, *i.e.*, they absorb all information quickly, but not necessarily *fundamentally* efficient, *i.e.* absorbing information narrowly relevant to future profitability); David J. Schulte, *The Fraud on the Market Theory: Efficient Markets and the Defenses to an Implied 10b-5 Action*, 70 Iowa L. Rev. 975, Sec. I.C. p. 985 (1985) ("Isolating Effects of Information on Market Price: Causation and Damages"; impact of an alleged misrepresentation can be determined by using the tools of financial economics to measure its effect on the market price of a security); Roger J. Dennis, *Materiality and the Efficient Capital Market Model: A Recipe for the Total Mix*, William & Mary L. Rev., Vol 25, No. 3, 373, 381 (1984) ("If the efficient market model were the explicit basis of the inquiry into materiality, then a court would focus on .... [whether] the information [was] of the quality that would change the consensual belief concerning the value of a security.") In an efficient market the affect on the market of an announcement remains a question of fact.

Computer Securities Lit., 886 F.2d 1109, 1119 (9th Cir. 1989).[17]

The second circuit understood the distinction between acceptance of the efficient market theory and valuation when it held:

> "The unresolved issue is whether the effects of the alleged artificial raising of stock price. . . could reasonably have been expected by the company not to have been *completely* dissipated by the announcement of the rights offering..."

(31a) (emphasis supplied).

No fewer than a pair of developments must take place beforehand. The first is to test the hasty conclusion that the disclosure of the rights offering "completely dissipated" *all* the favorable information concerning the possible strategic alliances (31a, 38a). The stock action certainly indicated otherwise. If one must make bares bones cases, consider the market action of Time Warner in a vacuum without benefit of a record or expert testimony. It would appear that the rights offering did not drain all the hopes and expectations from the market concerning strategic alliances.[18] It was obvious to the

---

[17]. *See also, Hanon v. Dataproducts Corp.*, 976 F.2d at 503-04; *Ross v. Bank South, N.A.*, 837 F.2d at 1001-02; *Sirota v. Solitron Devices, Inc.* 673 F.2d at 574.

[18]. On December 12, 1991, the commencement of the class period, the Time Warner shares traded at about $86 per share.

(continued...)

majority, as it was earlier to this Court (*Basic*, 485 U.S. at 249 & n.29), that expert testimony will be required and tested before the fact trier can value the corrective information.[19]

---

[18](...continued)
On June 3, 1991 (two days before defendants' disclosure of the rights offering), the stock price had risen to $119.00. Following public announcement of the offering, Time Warner shares declined to a closing price of $99.50 on June 6 and moved down a few dollars more per share in the succeeding days. On this most rudimentary basis, it is reasonable to infer that there was significant inflation in the marketplace even after disclosure of the rights offering.

[19]. Petitioners' contention that the fraud-on-the-market theory operates unequally (12-13) stands rebuked by *Basic's* clear holding that the theory creates no more than a rebuttable presumption. 485 U.S. at 248-49. *See, e.g., Abell v. Potomoc Ins. Co.*, 858 F.2d 1104, 1120 (5th Cir. 1988), *vacated in part on other grounds sub nom., Fryar v. Abell*, 492 U.S. 914 (1989), and *cert. denied, Abell v. Wright, Lindsey & Tennings*, 492 U.S. 918 (1989). Courts have abided by this aspect of *Basic* in dismissing claims. *See, e.g., In re Apple Computer Securities Lit.*, 886 F.2d 1109 (9th Cir. 1989). Furthermore, respondents are not using the efficient market theory as sword and denying it as shield (12). We acknowledge the efficiency of the market. We posit only that the value ascribed to an item of information cannot be precisely quantified by reference solely to the pleadings. A factual record is required. One other side bar comment: It is probable to a near certitude that at trial petitioners will argue vigorously that the value of the information in the marketplace cannot be determined without the offer of expert testimony.

The court of appeals was clearly correct in leaving to a factual day determination of how much and for how long inflation remained in the market following the June 1991 disclosure.

Neither petitioners nor dissent acknowledges the distinction between presumptive acceptance of the efficient market theory and the need to develop a record to value the market impact of particular information.

It follows then that respondents need not quarrel with "the notion that markets impound available information relatively promptly in share prices, at least in widely traded companies, pervades securities law" (40a). Nor need we wrestle with *Basic's* recognition that "recent empirical studies have tended to confirm congress's premise that the market price of shares traded on a well developed markets reflect all available information . . ." 485 U.S. at 246. We simply observe, elementarily, that the application of these principles to determine the exact market response requires findings that cannot be upon the back of a pleading, much less one drafted *sine* discovery.

D. Petitioners' Arguments Are Entirely Irrelevant To The Alternative *Scienter* Theory.

Even if petitioners were correct that the logic of their motives could be determined as a matter of law, it would not disturb the alternative *scienter* theory that petitioners "were motivated to misrepresent the status of the strategic alliance negotiations to avoid jeopardizing talks with prospective partners..." (30a). The dissent addressed this theory only in passing and miscomprehending fashion (see pp. 8-9 *supra*). There is nothing irrational about the theory, and petitioners do

not contend that there is. Nor do petitioners and dissent contend with the possibility that petitioners may be found to have been reckless in failing to update the market.[20] Thus, the validity of this theory remains untouched even assuming *arguendo* that the June 1991 disclosure immediately drained all inflation from Time Warner's common stock.

II. IF THE COURT GRANTS THE PETITION, THEN IT SHOULD REVIEW THE SECOND CIRCUIT'S DETERMINATION THAT CERTAIN STATEMENTS ARE NOT ACTIONABLE.

The appellate court ruled as a matter of law that two distinct sets of statements alleged in respondents' complaint could not support a 10b-5 action.

First, the court held that statements by unnamed corporate spokesmen published by securities analysts or reporters are not actionable (20a-24a).[21] This holding blinks reality, improperly expands rule 9(b) pleading requirements, is

---

[20]. *See*, n. 9, *supra*.

[21]. Accordingly, the court of appeals ordered that any class to be certified include only purchasers of Time Warner stock from May 1, 1991 to June 6, 1991, eliminating the period of December 12, 1990 to April 30, 1991 underlying count III (35a n.8). Between December 12 and May 1, Time Warner's stock rose from $86 to about $108. Surely it cannot be determined as a matter of law that none of this change was attributable to statements regarding alliances.

inconsistent with prior decisions of the Court, with the import of *Basic*, and conflicts with the law of other circuits.

Second, the court held that statements attributed to petitioners before May 1, 1991 touting their prospects for entering strategic alliances "lack[ed] the sort of definite positive projections that might require later correction" (26a). Such a determination defies applicable precedent, including this Court's holding in *Virginia Bankshares*, and also conflicts with the laws of other circuits.

A. Statements By Unnamed Corporate Spokesmen Are Not Necessarily Immaterial.

The marketplace thrives on analysts' and news reports, and the evidence will show that analysts routinely validate their comments with company spokesmen. This was certainly the view of the second circuit in *Panzirer v. Wolf*, 663 F.2d 365, 366-67 (2d Cir. 1981), where the court allowed plaintiff to proceed following conceded reliance on a news column reporting unattributed analysts' reports and on Standard & Poor's tear sheets. *See also, Apple Computer*, 886 F.2d at 1115-16, 1118-19 (summary judgment granted *against* plaintiffs notwithstanding expert's testimony that market placed more weight on attributed statements because press and analysts' reports fully explained what defendants had not; the essence of *Apple* is that unattributed statements may be actionable); *see also, Wielgos v. Commonwealth Edison Co.*, 892 F.2d 509, 514-15 (7th Cir. 1989) (analysts serve to interpret company statements). *Cf., Basic*, 485 U.S. at 246 & n.24 ("market professionals generally consider most publicly announced statements *about* companies, thereby affecting stock market prices" (emphasis supplied)). Whether investors consider non-attributed statements in the total mix of investing

information is one of fact, to be answered case by case. See, *TSC Industries, Inc. v. Northway*, 426 U.S. 438, 448-50 (1976).[22]

It was also wrong for the court to have burdened respondents with the futile, pre-litigation tasks of identifying the specific corporate sources. The requirement of such specific identification also introduces an improper evidentiary requirement into rule 9(b), especially where defendants are in exclusive possession of spokesperson identities. Compare, rules 8, 9(b), Fed. R. Civ. P.; *see, Michaels Bldg. Co. v. Ameritrust Co., N.A.*, 848 F.2d 674, 679-80 (6th Cir. 1988); 5 Wright & Miller, *Federal Practice and Procedure:* Civil 2d §1298 (1990) ("circumstances constituting fraud could not have been pleaded with greater particularity without pleading 'evidence'").

---

[22]. Materiality is widely considered to implicate mixed questions of law and fact. *See, Levinson v. Basic*, 871 F.2d at 564 n.1 (on remand from Supreme Court); *Rowe v. Maremont Corp.*, 850 F.2d 1226, 1234 (7th Cir. 1988); *Garcia v. Cordova*, 930 F.2d 826, 829 (10th Cir. 1991); *Craftmatic Securities Litigation v. Kraftsow*, 890 F.2d 628, 641 (3d Cir. 1989).

It would appear that the second circuit was fixated on the unlikelihood that companies would intentionally seed misinformation (23a) rather than the relevant Supreme Court authority. Of course, evidence that this *occasionally* occurs does exist, but regardless the second circuit ignored the scenario of a company recklessly failing to provide information. See, n. 9 *supra*. And what about the corollary proposition. How likely is it that the financial press would intentionally fictionalize corporate statements?

At the least, there is a conflict between circuits on an important issue.

B. The Second Circuit Wrongly Concluded That The Contents Of Pre-May 1, 1991 Statements Were Not Actionable As A Matter of Law.

In light of *Virginia Bankshares* and the materiality standards of *Basic*, the court of appeals was wrong to have concluded as a matter of law and without a factual record that pre-May 1 statements concerning strategic alliances were immaterial. We cannot presume that the market for Time Warner did not move from $86 to about $108 in response to "immaterial" remarks.[23] And it renders language meaningless

---

[23]. Among the "immaterial," *attributed* statements; (i) "Time Warner has spent a good deal of the past year discussing with potential partners the mutual advantages we can derive from well-planned and strategically-executed alliances at the subsidiary level" (1990 Annual Report) 3d am. compl., ¶57; (ii) Time Warner "was continuing talks with potential foreign partners. We're not selling or buying," [Nicholas] added, "We're partnering" (3/15/91). *Id.*, ¶63 (25a n.3). Statements by unnamed corporate spokesmen included: (i) "we are in the process of selecting from among [interested prospects] those that share our vision" (2/15/91). *Id.*, ¶59 (21a n.2); (ii) Time Warner executives said that they are "in the process of selecting" partners from "among many prospects they had met". (Wall St. J., 2/21/91). *Id.*, ¶61 (22a n.2); (iii) Time Warner spokesmen quoted as saying that talks re possible alliances had "intensified". *Id.*, ¶65 (22a n.2).

to characterize the pre-May 1 statements as mere opinions (26a). These statements reported *status quo*. If petitioners said they were "partnering" or "selecting" or talks were "intensifying" when they were not, the *status quo* has been actionably mispresented.

The principles of *Virginia Bankshares* apply *a fortiori*. There, this Court held that directors' statements of reasons, opinions or belief, even if stated in conclusory terms such as "fair" or "high" value for tendered shares are actionable under rule 14a-9.[24] 111 S.Ct. at 2757-59. The Court found "no room to deny that a statement of belief by corporate directors about a recommended course of action" is material. *Id.* at 2757. *Virginia Bankshares* involved the claim that shareholders faced with a proxy request find directors' beliefs about recommended future corporate structure important. *Id.* We have more than "beliefs." We are dealing with news from the front. Regardless, prospective Time Warner shareholders found it important to have the company's views regarding alliances prior to casting their investment decisions. How can it be said as a matter of law that they did not. The market action bears witness to materiality. And the irony is not lost that, even under petitioners' view of the efficient market theory, such information *must* be considered.

---

[24]. Rule 14a-9, the basic anti-fraud provision of the Exchange Act rules governing proxies, is analogous to Rule 10b-5's anti-fraud prescription. In *Basic*, this Court applied the materiality standard for proxies articulated in *TSC Industries*, 426 U.S. at 449, to the 10b-5 context. 485 U.S. at 232.

The second circuit did not adhere to *Virginia Bankshares*; it also created another conflict among circuits[25] on another important issue.

---

[25]. At least three circuit courts of appeals have followed *Virginia Bankshares* in holding that statements of reasons, opinions or belief may be actionable under rule 10b-5. *Mayer v. Mylod*, 988 F.2d 635, 639-40 (6th Cir. 1993) (bank stated, *inter alia*, that it intended to have strong financial controls and that its loan portfolio was "soundly underwritten"); *Hanon v. Dataproducts Corp.*, 976 F.2d 497, 501-03 (9th Cir. 1992) (corporation misled market by touting new product line despite technical problems); *Shapiro v. UJB Financial Corp.*, 964 F.2d 272, 282-83 (3rd Cir. 1992) (bank officers' statements of opinion misrepresented status of loan loss reserves, financial health, lending practices and internal controls).

CONCLUSION

For all the reasons demonstrated above, the Court should not grant the petition for a writ of certiorari. If the Court determines to grant the petition, we respectfully submit that the scope of review should include the conditional issues raised by respondents.

Dated: February 22, 1994

Respectfully submitted,

KAUFMAN MALCHMAN KIRBY
& SQUIRE
Roger W. Kirby
Daniel R. Robbins
919 Third Avenue, 11th Floor
New York, New York 10022
(212) 371-6600

Attorneys for Respondent Zonon